

Case No: 62345
Event No 505862
Dec. No: 100/09/COL

EFTA SURVEILLANCE
AUTHORITY

EFTA SURVEILLANCE AUTHORITY DECISION

of 27 February 2009

concerning the amendments to the national allocation plan for the allocation of greenhouse gas emission allowances notified by Norway in accordance with the Act referred to at point 21al of Annex XX to the Agreement on the European Economic Area (*Directive 2003/87/EC of the European Parliament and of the Council of 13 October 2003 establishing a scheme for greenhouse gas emission allowance trading within the Community and amending Council Directive 96/61/EC*), as adapted to the Agreement by Protocol 1 thereto

THE EFTA SURVEILLANCE AUTHORITY

Having regard to the Agreement on the European Economic Area,

Having regard to the Agreement between the EFTA States on the Establishment of a Surveillance Authority and a Court of Justice (hereinafter "the Surveillance and Court Agreement"),

Having regard to the Act referred to at point 21al of Annex XX to the EEA Agreement,

Directive 2003/87/EC of the European Parliament and of the Council of 13 October 2003 establishing a scheme for greenhouse gas emission allowance trading within the Community and amending Council Directive 96/61/EC,

as adapted to the Agreement by Protocol 1 thereto (hereinafter "the Act"), in particular Article 9(3) thereof,

Having regard to the following considerations:

I. AMENDMENTS TO THE NATIONAL ALLOCATION PLAN

1. Procedure

The Norwegian National Allocation Plan for the Emissions Trading System in 2008-2012, developed under Article 9(1) of the Act, was notified to the

EFTA Surveillance Authority (hereinafter “the Authority”) by letter dated 28 March 2008.

Following its assessment of the national allocation plan of Norway, the Authority concluded, in its Decision No. 504/08/COL of 16 July 2008¹, paragraph 1, that the following aspects of the national allocation plan were incompatible with criterion 5 of Annex III to the Act:

- the allocation methodology by which allowances are determined at installation level with regard to land-based industry according to Section 7(2) and (3), cf. Section 8 (2) of the Norwegian Act of 17 December 2004 No. 99 relating to greenhouse gas emission allowance trading and the duty to surrender emission allowances, as amended on 29 June 2007;
- the definition of a new entrant laid down in Chapter 3.2 of the Norwegian national allocation plan in order to qualify for the special reserve in Section 7(4) of the said Act of 17 December 2004 No. 99;
- the creation of a special new entrants’ reserve in Section 7(4) of the said Act of 17 December 2004 No. 99 to the extent the reserve applies to new gas-fired power plants based on carbon capture and storage (CCS) technology.

Pursuant to paragraph 4 of Decision No. 504/08/COL of 16 July 2008, Norway was requested to notify amendments of the national allocation plan made to correct the incompatibilities indicated in paragraph 1 of that Decision as soon as possible, taking into account the time-scale necessary to carry out the national procedures without undue delay, such amendments requiring prior acceptance by the Authority pursuant to Article 9(3) of the Act.

Norway notified to the Authority, by letter dated 15 December 2008, information concerning certain amendments to its national allocation plan. The information included in the “*Norwegian National Allocation Plan for the Emission Trading System in 2008-2012 - Revisions in response to ESA’s decision of 16 July 2008*” (hereinafter “the Revisions of the National Allocation Plan”) focused on the amendments to the national allocation plan proposed by Norway in order to address the objections raised in the Authority’s decision of 16 July 2008. The Norwegian Government specified that all other main elements of the plan remained as described in the initial national allocation plan notified on 28 March 2008.

The main rules concerning the allocation of allowances to installations covered by the Emission Trading Scheme had been laid down in Section 7 and Section 8 of the Norwegian Act of 17 December 2004 No. 99 relating to greenhouse gas emission allowance trading and the duty to surrender emission allowances², as amended on

¹ EFTA Surveillance Authority Decision No. 504/08/COL of 16 July 2008 concerning the national allocation plan for the allocation of greenhouse gas emission allowances notified by Norway in accordance with the Act referred to at point 21a) of Annex XX to the Agreement on the European Economic Area (*Directive 2003/87/EC of the European Parliament and of the Council of 13 October 2003 establishing a scheme for greenhouse gas emission allowance trading within the Community and amending Council Directive 96/61/EC*), as adapted to the Agreement by Protocol 1 thereto.

² LOV 2004-12-17 nr 99: Lov om kvoteplikt og handel med kvoter for utslipp av klimagasser (klimakvoteloven).

29 June 2007 (hereinafter “the Norwegian Emissions Trading Act”). Thus, in parallel to the issuance of the proposed Revisions of the National Allocation Plan, the Norwegian Government submitted to the Norwegian Parliament, on 12 December 2008, a bill proposing amendments to Sections 7 and 8 of the Norwegian Emissions Trading Act³. The proposed amendments reflected the required changes regarding the allocation to existing installations, the reserve and the definition of a new entrant.

The Norwegian Government specified that the Revisions of the National Allocation Plan, notified to the Authority on 17 December 2008, were conditional on the Norwegian Parliament’s endorsement of the proposed amendments to the Norwegian Emissions Trading Act. By letter dated 20 February 2009, the Norwegian Government informed the Authority that the Norwegian Parliament approved the proposed amendments to Sections 7 and 8 of the Norwegian Emissions Trading Act without any changes on 19 February 2009. The Authority was informed on 27 February 2009 that the amending law had entered into force on the same day.

2. Revisions of the National Allocation Plan

As stated by Norway, the amendments to its national allocation plan aimed to address the objections raised by the Authority in its decision of 16 July 2008, i.e.

- the rules providing no allocation for free to installations that were established after 2001, but had a greenhouse gas emissions permit as of 28 March 2008, which represented undue discrimination compared to installations established earlier;
- the date defining existing installations versus new entrants, which should be the date of the notification of the national allocation plan (28 March 2008), and not the date of the entry into force of the Act of 29 June 2007 No. 93 amending the Norwegian Act of 17 December 2004 No. 99 relating to greenhouse gas emission allowance trading and the duty to surrender emission allowances (1 July 2007);
- an exclusive reserve for gas-fired power plants based on carbon capture and storage (CCS) technology that could not be accepted.

Norway indicated that the amendments to the allocation methodology for land-based industry installations covered by the Emission Trading Scheme have been designed to respond to the concerns expressed by the Authority, in particular those relating to allocation to existing installations that were established after 2001 or installations that had significantly increased emissions due to significant changes in the nature and scale of their activities after 2001, but held a greenhouse gas emissions permit by 28 March 2008.

“New existing” installations, i.e. land-based installations established after 2001, which had no emissions prior to 2002 and were holding a complete greenhouse gas emission permit by 28 March 2008, will be allocated allowances free of charge according to the new allocation rules described in the Revisions of the National Allocation Plan. The allocation principles have been laid down in Section 7 of the Norwegian Emissions Trading Act as amended on 27 February 2009 (hereinafter “the amended Norwegian Emissions Trading Act”) and detailed allocation methodologies set out in Section 8

³ Ot.prp. nr. 19 (2008-2009) Om lov om endringer i klimavoteloven.

thereof. Pursuant to Section 8(3) of the amended Norwegian Emissions Trading Act, “new existing” installations will primarily be allocated allowances free of charge based on their average historic emissions in the years in which they were in operation during the 2002-2007 period. Regarding “new existing” installations without a full calendar year of operation during the 2002-2007 period, i.e. installations in place between 1 January 2007 and 28 March 2008, Section 8(4) of the amended Norwegian Emissions Trading Act foresees that allocation of allowances free of charge to these installations will be based on the relevant benchmarks set out in that provision.

Furthermore, in order to avoid undue discrimination between these “new existing” installations being allocated allowances on the basis of more updated emissions data and the installations with emissions during the 1998-2001 base period that have significantly increased emissions due to significant changes in the nature and scale of their activities after 2001, additional provisions have been introduced to provide for an increased allocation reflecting the extension. Pursuant to Section 8(7) of the amended Norwegian Emissions Trading Act, installations with emissions during the 1998-2001 period, which significantly increased their emissions after 2001 based on significant changes in the nature and scale of their activities, will be allocated allowances free of charge either based on their average historic emissions during the 2002-2007 period, calculated from the year in which the extensions came into operation, or, where the extension has been in operation for less than a full calendar year before 28 March 2008, on the basis of the benchmarks set out in Section 8(4) of that Norwegian Act.

Regarding the notion of new entrants and the cut-off date used to distinguish between existing installations and new entrants, Section 7(1)(a) of the amended Norwegian Emissions Trading Act date refers to the date of the notification of the national allocation plan, i.e. 28 March 2008, in conformity with Article 3(h) of the Act.

Moreover, Section 7(2) of the amended Norwegian Emissions Trading Act foresees the establishment of a reserve limited to highly efficient combined heat and power plants, thus excluding new gas-fired power plants based on carbon capture and storage (CCS) technology from such a reserve. As indicated in the Revisions of the National Allocation Plan, no changes to the rules for allocation to highly efficient combined heat and power plants have been made compared to those presented in the initial national allocation plan notified on 28 March 2008. Accordingly, only highly efficient combined heat and power plants can qualify for allocation from the special new entrants’ reserve in order to be granted allowances free of charge according to the defined benchmarks.

II. ASSESSMENT

The amendments of the national allocation plan have been evaluated against the criteria contained in Annex III to the Act, taking into account the relevant provisions of the methodology set out in the Commission’s guidance documents COM(2003) 830 final, COM(2005) 703 final and COM(2006) 725 final for the assessment of a national allocation plan under Article 9(3) of the Act as applied in the Commission’s decisions on national allocation plans.

All aspects of the amendments of the national allocation plan have been found compatible with those criteria, in particular with criterion 5 of Annex III to the Act, and are therefore accepted. There are no indications that these amendments to the allocation methodology are likely to unduly favour certain installations or sectors.

The amendment of the national allocation plan to provide allocation of allowances free of charge to land-based installations established after 2001, which had no emissions prior to 2002 and were holding a complete greenhouse gas emission permit by 28 March 2008, pursuant to Section 7(1)(a) and Section 8(3) and (4) of the amended Norwegian Emissions Trading Act, is consistent with Annex III to the Act, in particular its criterion 5, and is therefore accepted.

The amendment of the national allocation plan to introduce special allocation rules for land-based installations with emissions during the 1998-2001 base period that had significantly increased emissions due to significant changes in the nature and scale of their activities after 2001, as laid down in Section 8(7) of the amended Norwegian Emissions Trading Act, is consistent with Annex III to the Act, in particular its criterion 5, and is therefore accepted.

The amendment of the national allocation plan to bring the notion of new entrant, and consequently the distinction between existing installations and new entrants, in conformity with the provisions of Article 3(h) of the Act, as foreseen in Section 7(1)(a) of the amended Norwegian Emissions Trading Act, is consistent with Article 3(h) of the Act and its Annex III, in particular its criterion 5, and is therefore accepted.

The amendment of the national allocation plan to restrict the allocation of allowances free of charge from the special new entrants' reserve to highly efficient combined heat and power plants, and thus remove the eligibility of new gas-fired power plants based on carbon capture and storage (CCS) technology for that reserve, as laid down in Section 7(2) of the amended Norwegian Emissions Trading Act, is consistent with Annex III to the Act, in particular its criterion 5, and is therefore accepted.


HAS ADOPTED THIS DECISION


1. The following aspects of the proposed amendments to the national allocation plan of Norway for the first five-year period mentioned in Article 11(2) of the Act are compatible with the Act, in particular with criterion 5 of Annex III to the Act, and therefore accepted:
 - the amendment of the national allocation plan to provide allocation of allowances free of charge to land-based installations established after 2001, which had no emissions prior to 2002 and were holding a complete greenhouse gas emission permit by 28 March 2008, pursuant to Section 7(1)(a) and Section 8(3) and (4) of the Norwegian Act of 17 December 2004 No. 99 relating to greenhouse gas emission allowance trading and the duty to surrender emission allowances, as amended on 27 February 2009.

- the amendment of the national allocation plan to introduce special allocation rules for land-based installations with emissions during the 1998-2001 base period that had significantly increased emissions due to significant changes in the nature and scale of their activities after 2001, as laid down in Section 8(7) of the said Act of 17 December 2004 No. 99, as amended on 27 February 2009;
 - the amendment of the national allocation plan to bring the notion of new entrant, and consequently the distinction between existing installations and new entrants, in conformity with the provisions of Article 3(h) of the Act, as foreseen in Section 7(1)(a) of the said Act of 17 December 2004 No. 99, as amended on 27 February 2009;
 - the amendment of the national allocation plan to restrict the allocation of allowances free of charge from the special new entrants' reserve to highly efficient combined heat and power plants, and thus remove the eligibility of new gas-fired power plants based on carbon capture and storage (CCS) technology for that reserve, as laid down in Section 7(2) of the said Act of 17 December 2004 No. 99, as amended on 27 February 2009.
2. This Decision shall enter into force upon its notification.
 3. This Decision is authentic in the English language.
 4. This Decision is addressed to Norway and shall be notified to that State.

Done at Brussels, 27 February 2009.

For the EFTA Surveillance Authority


Per Sanderud
President


Kristján Andri Stefánsson
College Member

Case No: 62345
Event No 483630
Dec. No: 504/08/COL

EFTA SURVEILLANCE
AUTHORITY

EFTA SURVEILLANCE AUTHORITY DECISION

of 16 July 2008

concerning the national allocation plan for the allocation of greenhouse gas emission allowances notified by Norway in accordance with the Act referred to at point 21a1 of Annex XX to the Agreement on the European Economic Area (*Directive 2003/87/EC of the European Parliament and of the Council of 13 October 2003 establishing a scheme for greenhouse gas emission allowance trading within the Community and amending Council Directive 96/61/EC*), as adapted to the Agreement by Protocol 1 thereto

THE EFTA SURVEILLANCE AUTHORITY,

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Having regard to the Act referred to at point 21a1 of Annex XX to the EEA Agreement,

Directive 2003/87/EC of the European Parliament and of the Council of 13 October 2003 establishing a scheme for greenhouse gas emission allowance trading within the Community and amending Council Directive 96/61/EC,

as adapted to the Agreement by Protocol 1 thereto (hereinafter “the Act”), in particular Article 9(3) thereof,

Having regard to the following considerations

I. THE NATIONAL ALLOCATION PLAN

1. Procedure

The Norwegian National Allocation Plan for the Emissions Trading System in 2008-2012, developed under Article 9(1) of the Act, was notified to the

EFTA Surveillance Authority (hereinafter “the Authority”) by letter of 28 March 2008 and registered by the Authority on 2 April 2008. The Norwegian Government submitted additional information on the notified plan by letter dated 30 May 2008, registered on 2 June 2008, in reply to questions from the Authority submitted by letter dated 17 April 2008. The Norwegian Government notified to the Authority by letter dated 7 July 2008 certain information concerning an amendment to its national allocation plan.

The Norwegian Government presented its national allocation plan for discussion in the EU Climate Change Committee on 18 April 2008.

The EFTA Committee on greenhouse gas emission trading assisting the Authority (hereinafter “the EFTA Committee”) also considered the national allocation plan. The EFTA Committee called on the Authority to assess all national allocation plans on a consistent, coherent and robust basis. The EFTA Committee also urged the Authority to take into account the importance of preserving the integrity of the internal market and to avoid undue distortions of competition. The EFTA Committee called on the Authority to examine the treatment of installations, in particular with regard to the cut-off date and the exception on the use of surplus gas. The Committee also called on the Authority to examine the application of the new entrants’ reserve, in particular the intention to use the reserve for carbon capture and storage (CCS) and the date of application. The views of the EFTA Committee have been taken into account.

The national allocation plan has been evaluated by the Authority against the criteria in Annex III to the Act and after having consulted the European Commission. Whereas the Norwegian national allocation plan in most respects, does not raise problems in relation to EEA law, certain aspects of the plan have, nevertheless, been found incompatible with those criteria, and in particular with criterion 5 in Annex III to the Act.

2. The Norwegian Allocation Plan

The principles governing the Norwegian allocation methodology have been set forth in Chapter 2 on the determination of the total number of allowances and allocation of allowances of the Norwegian Act of 17 December 2004 No. 99 relating to greenhouse gas emission allowance trading and the duty to surrender emission allowances¹, as amended on 29 June 2007 (hereinafter “the Norwegian Act”). The main rules concerning the allocation of allowances to installations covered by the Emission Trading Scheme are laid down in Section 7 and Section 8 of the Norwegian Act.

The general formula for allocating allowances free of charge to land-based existing installations is based on the historical emissions of the installations during the base period 1998-2001 (fixed historical period). Land-based industry installations covered by the Emission Trading Scheme will be allocated an amount of allowances free of charge corresponding to 100 % of their annual average emissions from industry processes during the base period 1998-2001 and 87% of their annual average emissions from energy related activities during the base period 1998-2001. Pursuant

¹ LOV 2004-12-17 nr 99: Lov om kvoteplikt og handel med kvoter for utslipp av klimagasser (klimakvoteloven).

to Section 7(3) of the Norwegian Act, the general rule is that no other installation covered by the Emission Trading Scheme will receive allowances free of charge. The application of the general allocation formula read in conjunction with Section 7(3) implies that existing installations starting to operate after the base period 1998-2001 will not be allocated any allowances free of charge. This is so as these installations did not have emissions during 1998-2001. Hence, the undertakings will have to buy all their allowances on the market.

Similarly, those installations that have extended their capacity and therefore their emissions after that base period will not receive any allowances free of charge corresponding to their extension of capacity. Concerning land-based incumbents, Section 7(2)(2) of the Norwegian Act provides for one exception to the general rule of Section 7(3) to buy allowances: the allocation may accommodate installations which utilise surplus gas from land-based industries that are not included in the trading scheme or subject to an emission tax.

Besides, it stems from Section 7(3) of the Norwegian Act as well as from the fact that only certain existing land-based installations are entitled to allowances free of charge that no existing installations covered by the Emission Trading Scheme in the offshore sector will be allocated allowances free of charge. Consequently, such installations will need to purchase all their allowances on the market irrespective of their starting date of operation.

It also stems from Section 7(3) that new entrants will not be allocated any allowances free of charge, except those which will be eligible to the specific reserve foreseen in Section 7(4): the new entrants' reserve for new gas-fired power plants that will be based on carbon capture and storage technology and new highly efficient combined heat and power plants. However, offshore installations are excluded from the possibility to be allocated allowances free of charge from the new entrants' reserve.²

II. ASSESSMENT

1. Criterion 5

As long as the general rules of the Act are respected, it is not for the Authority to interfere with a State's decision as to how many allowances should be granted for free. Whether, and if so to what extent, allowances are sold in auction or in any other way is likewise not a matter for the Authority. What the Authority must assess is whether the national plan *distributes* the allowances in a manner that does not unduly discriminate. In other words, *when* a state has decided that a given number of allowances should be given for free, it falls for the Authority to verify that these free allowances are distributed among undertakings in a manner that respects the principle of equal treatment and the State aid rules. In the following the rules will be explained, before the Authority assesses the compliance of the national allocation plan with those rules.

² The Norwegian national allocation plan specifies that energy producing activities that are covered by the Act Relating to CO₂ Tax in the Petroleum Activity on the Continental Shelf do not qualify for an allocation free of charge from the new entrants' reserve.

1.2. The link between criterion 5 and the principle of equal treatment

Pursuant to criterion 5 in Annex III to the Act, the national allocation plan shall not discriminate between companies or sectors in such a way as to unduly favour certain undertakings or activities, cf. the requirements of the EEA Agreement, in particular Article 61 thereof and Article 1 of Protocol 3 to the Surveillance and Court Agreement. In the following the Authority will give its provisional and preliminary assessment of the compliance of the national allocation plan of Norway with the said provisions.

As held by the Court of First Instance,

“criterion 5, whose wording expressly refers to the concept of discrimination, [is] ... the specific application of the general principle of equal treatment in the context of implementation by the Member States of Directive 2003/87 and, more specifically, in the context of the allocation of allowances effected on the basis of the NAPs”.

As the Court further held, this implies that an assessment as to whether criterion 5 is respected must be based on the general

*“conditions, as recognised by the case-law, governing application of the principle of equal treatment, that is to say, in particular, the need to compare the situation of the persons concerned (‘comparable incumbents’) and the possibility of objectively justifying discrimination (‘adaptations ... for justified reasons’). Indeed, according to that case-law, the principle of equal treatment requires that comparable situations must not be treated differently and that different situations must not be treated in the same way unless such treatment is objectively justified”.*³

One objective of a national allocation plan should be to ensure a reasonably fair share-out of the task of emission reductions 1) between sectors participating in the trading scheme and the rest of the economy, 2) among sectors participating in the trading scheme, and 3) among installations in the participating sectors. Therefore, the allocation methodology shall not favour certain undertakings or activities, unless this is justified by the environmental logic of the system itself or such rules are necessary for consistency with duly justified environmental policies.

1.2. The link to the State aid rules in Article 61 of the EEA Agreement

It is recognised that tradable permit schemes may involve State aid in various ways. In the framework of the Emission Trading Scheme set by the Act, the allocation of allowances free of charge to certain activities confers an economic advantage to undertakings which has the potential to distort competition and affect trade between Contracting Parties to the EEA Agreement.

As regards the use of State resources and their imputability to Norwegian authorities, the following elements are relevant.

³ Case T-374/04 *Germany v. Commission*, judgment of 7 November 2007, paragraph 153.

Contrary to EU Member States, Norway is not bound by Article 10 of Directive 2003/87/EC which obliged EU Member States to allocate at least 90% of the allowances free of charge in the trading period from 2008 until 2012.⁴ Consequently, the allocation of allowances free of charge constitutes an advantage granted to the installations concerned through State resources, which appears to be imputable to the Norwegian State and to entail the use of State resources. Therefore, allocation by Norway of allowances free of charge to certain installations could involve State aid, irrespective of the percentage allocated.

The aspects of imputability and State resources are strengthened by Norway's participation as of 2008 in international emissions trading and in the other flexible mechanisms, i.e. the Joint Implementation and the Clean Development Mechanism. This enables a State to take further discretionary decisions influencing its budget and the number of allowances granted to industry. In particular, as all allocations must as from the start of the trading period from 2008 to 2012 be covered by Assigned Amount Units, which are tradable between contracting parties, any allocation free of charge directly reduces the quantity of Assigned Amount Units that each State can sell to other contracting parties or increases the need to buy such Assigned Amount Units.

The criteria used for the assessment of the State aid involved in the National Allocation Plans under the EU Emission Trading Scheme for the trading period from 2008 to 2012 have been set out in the new State aid environmental guidelines.⁵ State aid involved in tradable permit schemes may be declared compatible with the functioning of the EEA Agreement within the meaning of Article 61(3)(c) thereof, provided that the four following conditions are fulfilled: (a) the tradable permit schemes must be set up in such a way as to achieve environmental objectives beyond those intended to be achieved on the basis of Community standards that are mandatory for the undertakings concerned; (b) the allocation must be carried out in a transparent way, based on objective criteria and on data sources of the highest quality available, and the total amount of tradable permits or allowances granted to each undertaking for a price below their market value must not be higher than its expected needs as estimated for the situation in absence of the trading scheme; (c) the allocation methodology must not favour certain undertakings or certain sectors, unless this is justified by the environmental logic of the scheme itself or where such rules are necessary for consistency with other environmental policies; and (d) in particular, new entrants shall not in principle receive permits or allowances on more favourable conditions than existing undertakings operating on the same markets. Granting higher allocations to existing installations compared to new entrants should not result in creating undue barriers to entry.⁶

⁴ Article 1(2)(e) of the Decision of the EEA Joint Committee No. 146/2007 of 26 October 2007, which incorporated Directive 2003/87/EC into the EEA Agreement, states: "For the periods referred to in Article 11(2) and for the total quantity of allowances to be allocated for each period under Article 11(2), each EFTA State may allocate a greater percentage of its allowances against payment than any limitation established under Article 10."

⁵ The Authority's guidelines on State aid, chapter on State aid for environmental protection, as adopted on the 16 July 2008, section 3.1.12. *Aid involved in tradable permit schemes.*

⁶ Point 140 of the State aid Environmental guidelines.

According to the Court of Justice, state aid cannot be declared compatible with the common market if certain of the conditions for receiving the aid contravene the general principles of Community law, such as the principle of equal treatment.⁷

2. Offshore installations

According to the Norwegian national allocation plan, all offshore installations covered by the Emission Trading Scheme will be subject to the same allocations rules. Hence, neither incumbents nor new entrants will receive allowances free of charge.

The Authority acknowledges that the specificities of the sector and the importance of its emissions may, to a certain extent, justify a differentiated treatment for the offshore sector. The offshore sector, which covers oil and gas extraction, is economically regulated through a number of acts and regulations owing to the special conditions under which it operates. Given its major contribution in Norway's global CO₂ emissions, the offshore sector has been subject to a special CO₂ tax as an incentive to reduce its emissions since 1991. The specific CO₂ tax on the continental shelf is calculated on the basis of fuel consumption used for energy production and on the volume of gas that is flared. The rates of this special CO₂ tax are considerably higher than observed prices on CO₂ allowances in Europe (corresponding to more than NOK 300/tonne or 40 euro/tonne). To maintain at its current level the financial incentive to reduce CO₂ emissions generated by offshore installations, all offshore installations will have to buy their allowances on the market. In order to compensate for the increased costs linked to the purchase of their allowances on the market, the rate of the specific CO₂ tax on the continental shelf will be reduced by around 160 NOK/tonne CO₂. This figure corresponds to the observed price of EUA'08 allowances noted at Nordpool/ECX/EEX in September 2007.

In light of the objective of the Act and the requirements of its Annex III, the Authority considers that the stricter treatment of offshore installations covered by the Emission Trading Scheme as compared with land-based installations is justified by the specificity of this sector. In this respect, the Authority has taken into account that the Norwegian national allocation plan ensures an equal treatment of all installations in that sector, both incumbents and new entrants being subject to the same allocations rules.

3. Land-based existing installations

3.1. The Norwegian allocation rules and the presented justifications therefore

The general formula for allocating allowances free of charge to land-based existing installations sets a clear cut-off date of 1 January 2002. Installations that started to operate after that date, and therefore did not have emissions during 1998-2001, will be allocated no allowances free of charge. Hence, they will have to buy their allowances

⁷ Case C-390/06 *Nouva Agricast Srl*, judgment of 15 April 2008, paragraphs 49-51. In this respect, a parallel may be drawn to paragraph 158 (a) of the environmental guidelines according to which is a condition for the compatibility of aid in the form of exemption from environmental taxes that "the aid must be granted in principle in the same way for all competitors in the same sector/the relevant market if they are in a similar factual situation". Indeed, it has been spelled out explicitly in paragraph 141 of guidelines concerning the trading period post 2012 that this basic condition applies to allocation plans.

on the market and/or reduce their emissions. In contrast, existing installations which operated during that base period will be allocated an amount of allowances free of charge covering most of their emissions. This general allocation formula for incumbents leads to a difference of treatment between two groups of existing land-based installations, namely, on the one hand, installations operating prior to 2002 and, on the other hand, installations which started operations only from 2002 onwards. Not only land-based installations starting to operate after the base period 1998-2001, but also those that have extended their capacity and consequently their emissions after that base period will not receive any allowances free of charge to cover increased emissions corresponding to their extension of capacity.

The Norwegian Government acknowledges that an allocation methodology based on grandfathering will lead to different treatment between installations that are allocated allowances based on the historic emissions and installations that are allocated allowances based on alternative criteria. The Norwegian Government, however finds, that the allocation methodology for the 2008-2012 trading period is a balanced approach, taking into account the financial situation of existing industry while at the same time protecting the environmental integrity of the Emission Trading Scheme, considering that any investors making investment decisions after 2001 could have been aware of the fact that future CO₂ emissions may have a cost and that the size of costs may increase over time.

The Norwegian Government states that its methodology for allocating allowances free of charge, based on historic emissions data in a fixed period, is designed to protect the environmental logic of the scheme by avoiding the distortions of the environmental incentives to reduce emissions. This allocation methodology has been chosen with the aim to avoid that the granting of allowances free of charge will reduce the cost-effectiveness of the trade system. The Norwegian Government has chosen the fixed base period 1998-2001. This base period is the same as the one used for the Norwegian trading system in 2005-2007 to grant allowances free of charge to installations that started operations not later than 1 January 2001.⁸

The Norwegian Government considers it important to ensure that allowances free of charge are allocated in a way that does not influence the behaviour of the operators. In order to ensure that receivers of free allowances cannot influence the number of allowances they will receive by their present or future production or investment behaviour, the Government deems it necessary that the basis for the allocation of allowances free of charge must be fixed and must be perceived as fixed. According to the Norwegian Government, a moving base period from the first to the second trading period could have given reason for installations to expect that future base periods could include years in which they can influence emissions, and thus motivate strategic behaviour. Other alternatives such as benchmarks or projections would create expectations that full costs need not be paid in the future. This could lead to

⁸ Section 8(a) of the Norwegian Act of 17 December 2004 No. 99 relating to greenhouse gas emission allowance trading and the duty to surrender emission allowances. However, in the Norwegian trading scheme for 2005-2007, Section 8 also foresaw the allocation of allowances for free in other possible situations, i.e. installations not in operation throughout the base years or with atypical level of emissions; installations which, as a result of substantial changes in the nature or scale of their operations, had a substantial change in their emissions level during the period from 1 January 2001 to 31 December 2007; and installations that started operations or would certainly do so after 1 January 2001 but before 31 December 2007.

investments that are not environmentally justified.⁹ The Norwegian Government's message is that all operators will have to pay full emission costs in the future. Sale of allowances implies that operators and investors will face the full cost of their emissions.

The Norwegian Government acknowledges that the amount of allowances received free of charge will be a sort of "sunk" advantage/grant for the installation having received them. Still, it considers that, provided a functioning capital market is established, the decisions of market participants will not be based on what they can "afford", but on the expected profitability of the different activities. In the opinion of the Norwegian Government, a business decision to reduce or increase production volume or to reduce or expand capacity will therefore not depend on the number of allowances a company receives free of charge. If it is profitable and rational for an operator to reduce the production volume when allowances are sold, it will be just as profitable and rational to reduce the production volume by the same amount when allowances are handed out free of charge.

3.2. Comparability and the relevance of the concept of legitimate expectations

In the opinion of the Authority, land-based installations operating before 2002 and those starting to operate from 2002 find themselves in a comparable legal and factual situation in the light of the objectives pursued by the Act. Both groups of existing installations face the same obligations under the Emission Trading Scheme, notably an obligation to surrender allowances equal to the total emissions in each calendar year.

The Norwegian Government claims that installations starting operations after 2001 had no reasonable expectation that they would be allocated allowances free of charge in the period 2008-2012.

The Authority agrees that this is the case, but fails to see the relevance thereof for the purpose of assessing whether the difference of treatment is compatible with criterion 5. Neither "old" existing installations nor "new" existing installations had any legitimate expectation in the legal sense of the word, i.e. a legal right, that they would receive allowances for free under the 2008-2012 trading period.¹⁰ Indeed, the Norwegian Government never made an unequivocal promise to that effect to either of the two groups. Hence, none of them may therefore claim that they (independently of each other) have a legal right to receive free allowances for this trading period.

The question is therefore whether it could be argued that the two groups are nevertheless in non-comparable situations because the two groups when making their investment decisions had a completely different knowledge of the conditions under which they would operate.

⁹ Norwegian Allocation Plan for the Emission Trading System in 2008-2012, p. 12.

¹⁰ As indeed underlined in Norwegian Government's response to the Authority's questions, submitted by letter dated 30 May 2008, p. 8: "*No installation could have a legitimate expectation that it would be allocated allowances free of charge in the period 2008-2012.*" See also Ot.prp. nr. 13 (2004-2005), point 4.3, and Ot.prp. nr. 66 (2006-2007), point 2.6.

As acknowledged by the Commission, the Act allows States to treat new entrants less favourably compared to existing operators. Thus, if granting allowances for free to existing installations, States may choose to let new entrants buy allowances on the market. This difference of treatment does not amount to incompatible discrimination, since operators of existing installations may have made investments before they were aware of the need for them to contribute to greenhouse gas emission reductions. In contrast, operators of new installations will make investment decisions with certainty of the need for them to take their climate change impact into account.¹¹

However, as also underlined by the Commission, it is important to keep in mind that the new entrants issue is of a transitory character. What is a new entrant in one trading period will be an existing installation in the subsequent period.¹² In other words, new installations only fulfil the definition of a new entrant for a limited period of time, i.e. part of a trading period, *“and the cost of allowances for this limited period (probably less than two years in the first period) can be taken into account in the investment and timing decisions. The Directive guarantees that as of a certain point in time the new entrant will be allocated allowances in the same manner as all other existing installations for the remainder of the lifetime of the installation.”*¹³

On that basis the Commission has stated that it *“acknowledges only that existing installations and new entrants, which are recognised as a separate category under the Directive, may be allocated on the basis of a different methodology during one given trading period. Such different treatment can however not be justified once a new entrant in the preceding trading period turns into an existing installation in the following trading period with similar data material being available as for other existing installations. ... The starting date of operation cannot be used as the primary justification for discrimination between existing installations.”*¹⁴

Hence, in order to respect the principle of equal treatment, the methodology that a Member State uses in order to allocate allowances to new entrants should as far as possible be the same as the one used for comparable incumbents, and exceptions must be justified by reasons acknowledged under the Act.¹⁵

In the case at hand, the difference of treatment between competing operators does not consist of a different treatment between new entrants, on the one hand, and existing installations, on the other. Rather, it creates a difference of treatment between two groups of existing operators.

Considering that the Act only allows for a short transitional period relating to new entrants, it would seem natural to conclude that considerations pertaining to the length

¹¹ Reference is made to paragraph 56 of “Communication from the Commission on guidance to assist Member States in the implementation of the criteria listed in Annex III to Directive 2003/87/EC establishing a scheme for greenhouse gas emission allowance trading within the Community and amending Council Directive 96/61/EC, and on the circumstances under which force majeure is demonstrated” of 7 January 2004 (COM (2003) 830 final). In the following this document is referred to as the “NAP-1 guidance”.

¹² Paragraph 53 of the NAP-1 guidance.

¹³ Paragraph 56 of the NAP-1 guidance.

¹⁴ Commission Decision of 29 November 2006 concerning the national allocation plan notified by Germany, paragraphs 22-23.

¹⁵ Paragraph 61 of the NAP-1 guidance.

that an installation has been in operation and the likelihood that the installation “knew what it went into” cannot automatically justify a system that operates with a difference of treatment between existing operators.

In any event, under the former Norwegian emission trading scheme set in 2004 for the period 2005-2007 installations operating before 2001 were granted allowances free of charge according to the level of their emissions during the 1998-2001 period. Installations starting to operate after 2001 were also granted allowances for free, the sole difference being that this amount of allowances was determined according to another allocation methodology using their projected emissions and taking account of the potential, including the technological and economical potential, to reduce emissions through the use of best available techniques¹⁶. The planned changes of allocation rules introducing the difference of treatment only became known in March 2007 when the proposed amendments were submitted to the Parliament. Thus, the Norwegian allocation method for 2008-2012 does not make a distinction between establishments before and after the new plan became known. Rather, it makes a distinction between two groups of undertakings, both having established themselves before the new policy was made public. Hence, the two groups were in the same situation with respect to knowledge of the plan for 2008-2012 and thus had equal possibility to adapt their business to the new rules.

3.3. Assessment of the possible environmental justifications

The methodology behind a national allocation plan may not favour particular sectors or firms unless it can be justified under the Annex III criteria or under the environmental logic of the system itself.¹⁷ The question is therefore whether the more favourable treatment granted to installations operating before 2002 fulfils this requirement.

Before addressing this issue, the Authority would, however, underline that it cannot concur with the Norwegian Government’s argument that the difference of treatment will not affect the competitive situation of the market.¹⁸ As stated by the Government in the bill that underlies the present allocation plan, “*generally, allowances for free will contribute to make polluting industry more profitable than if it had to pay for the quotas. ... Allowances for free give those submitted to quotas reduced economic burdens compared to sale of quotas. This contributes to reduce the switch-over costs and the danger for close down of industry subject to competition*”¹⁹ To thereupon claim that it does not distort competition to impose different burdens on two groups of otherwise identical and competing undertakings runs counter to very principles on which the EEA Agreement is founded. Even assuming that it is correct when the

¹⁶ Section 8, 2 d) of the Norwegian Act of 17 December 2004 No. 99 relating to greenhouse gas emission allowance trading and the duty to surrender emission allowances. As stated in Ot.prp. nr. 13 (2004-2005), points 1 and 10.3, this provision was inserted with the very aim of preventing that undertakings beginning their operations after the historical cut-off date would be treated less advantageously than undertakings starting their operations before that date.

¹⁷ Point 140(a) of the environmental guidelines according to which the allocation methodology must not favour certain undertakings or certain sectors, unless this is justified by the environmental logic of the scheme itself or where such rules are necessary for consistency with other environmental policies.

¹⁸ Norwegian Government’s response to the Authority’s questions, submitted by letter dated 30 May 2008, p. 11-12.

¹⁹ Ot.prp. nr. 66 (2006-2007), points 2.7.6 and 15.1.

Government argues that “*the amount of allowances free of charge will not affect the undertakings behaviour in the relevant product markets*”, the consequence would not, as suggested by the Government, be that the different treatment of the two groups will “*not affect or distort competition*”.²⁰

3.3.1. Justifications based on the criteria set forth in Annex III to the Act

The Act allows for a certain differentiated treatment between activities and/or undertakings, as long as this can be justified under the Act. In this respect, criteria 3 and 11 cater for certain differences of treatment between activities while criteria 7 and 8 allow certain differences of treatment at installation level. The Norwegian Government does not argue that the allocation methodology it has chosen is based on the mere application of any of these criteria.

Pursuant to criterion 3, a State may take account of the potential, including the technological potential, of activities covered by the Emission Trading Scheme to reduce emissions in order to determine separate quantities of allowances per activity or sector. However, a State that chooses to apply this criterion shall compare the potentials of individual activities covered by the scheme to reduce emissions against each other. As acknowledged by Norway, the methodology developed in its national allocation plan only distinguishes between the two main sources of emissions, i.e. from energy activities and from industry processes, by applying different compliance factors for the allocation of allowances, respectively 0.87 for energy related emissions and 1 for process emissions, but in doing so does not rely on criterion 3.

Pursuant to criterion 11, a State may, in determining the quantity of allowances per activity, take into account the existence of competition from countries or entities outside the EEA, in cases where covered installations belonging to a specific activity would be rendered significantly less competitive, directly and predominantly, as a result of a major difference in climate policies between the EEA and countries outside the EEA. However, as underlined by the Commission, a State cannot use the mere existence of competition from outside the EEA as a reason to apply this criterion.²¹ Norway only indicated that the installations that will be granted allowances free of charge in Norway are mainly installations facing competition on regional or world markets, having limited possibilities to have the added cost incurred by the Emission Trading Scheme reflected in the product price.²² It did not apply that criterion in order to address that position nor did it to explain why installations that started operating after 2001 are not affected by such considerations.

Criterion 7 may justify a certain differentiation when allocating allowances among installations to accommodate early action. As elaborated in the Commission’s guidance documents²³, those installations that have already reduced greenhouse gas emissions in the absence of or beyond legal mandates should not be disadvantaged vis-à-vis other installations that have not undertaken such efforts. A State may apply this criterion to determine the quantity of allowances allocated to individual

²⁰ Compare page 12 of Norwegian Government’s response to the Authority’s questions, submitted by letter dated 30 May 2008.

²¹ Paragraph 105 of the NAP-1 guidance.

²² Norwegian Allocation Plan for the Emission Trading System in 2008-2012, p. 17.

²³ Section 2.1.7., in particular paragraphs 65-73, of the NAP-1 guidance.

installations. The application of this criterion necessarily implies fewer allowances available for installations that have not undertaken early action. The qualification as “early action” is limited to reductions of emissions beyond reductions made pursuant to Community or national legislation, or to actions undertaken in the absence of any such legislation. One option to accommodate early action undertaken in existing installations is to base the allocation on historical emissions by applying a relatively early base period. Those installations that have invested to reduce emissions since the base period would receive an allocation which covers a larger share of current emissions than installations that have not made such investments. However, a State using this approach would have to verify for each installation that the difference in emissions levels over time was not due to this installation having simply implemented legal requirements.

As stated in Chapter 6.2 of its national allocation plan, Norway considers that “*allocation based on a historic base period will favour installations that have undertaken measures since the base period and punish those who have increased emissions. Norway’s base period is 1998-2001, and thus reduction measures taken as early as 2002 will benefit the installations included in the trading system, since they will need fewer allowances.*”²⁴

In the opinion of the Authority, the economic advantage constituted by the allocation of allowances free of charge to all land-based installations operating before 2002 cannot be justified by a wish to reward early action. First, such installations are also required to contribute to the overall goal to reduce emissions, e.g. through the requirements under Directive 96/61/EC concerning integrated pollution prevention and control and the Best Available Techniques developed in that respect. Second, Norway has not indicated that it has verified, for each installation, that the difference in emissions levels over time was due to proven specific emission reductions undertaken by that installation and not simply due to its implementation of legal requirements. At the same time, installations starting to operate from 2002 that have undertaken early action since then are not rewarded under the Norwegian scheme and are indeed punished since they do not receive any allowances free of charge at all. Thus, the allocation methodology chosen by Norway for land-based existing installations cannot be considered as an accommodation of early action. Indeed, the allocation of allowances free of charge will benefit all installations that simply started operating before 1 January 2002 regardless of whether they can prove any specific emission reduction beyond legal mandates.

Criterion 8 enables a State to take account of clean technologies, including energy efficient technologies, in setting allocations at installation level. However, according to Chapter 6.3 of the Norwegian national allocation plan, allocation based on emissions in a historic period does not address clean technologies as such. To the contrary, the methodology chosen by Norway results in allocating allowances free of charge to all the installations that started to operate before 2002 regardless of whether they use such clean or energy efficient technology.

3.3.2. Consequences flowing from the use of a historical approach

²⁴ Norwegian Allocation Plan for the Emission Trading System in 2008-2012, p. 16.

It is generally accepted that an EEA State may make use of a historic period in order to determine the amount of allowances for free that shall be granted to existing undertakings. Still, the choice to use the approach of a historical period cannot in itself justify a differentiated treatment between existing installations. As underlined by the Commission²⁵, the starting date of operation cannot, therefore, be used as the primary justification for discrimination between existing installations where older existing installations, operating prior to 2002, are favoured simply and solely because they are older than other existing installations.

For the trading period from 2008 to 2012, several EU Member States have developed allocation methodologies using historical emissions data in order to determine the amount of allowances granted free of charge to the installations operating before a certain date. However, in those national allocation plans, installations starting to operate after the end of the selected historic base period were normally allocated allowances free of charge as well but on a different basis as they, by definition, did not have any emissions in the reference period. In other words, it was first and foremost because of the lack of data regarding their emissions during the reference period that the amount of allowances allocated free of charge to these installations was calculated on the basis of a different allocation methodology, i.e. using for instance emissions projections, Best Available Techniques (BAT) references or some kind of benchmarks, in case applying more stringent criteria. In contrast, in the Norwegian National Allocation Plan the historic period is used to determine whether undertakings will receive any allowances for free or not.

3.3.3. Justification based on the aim to ensure environmental effectiveness of the Emission Trading Scheme

The Authority has also examined whether the different treatment between the two groups of existing installations laid down in the Norwegian allocation methodology to land-based industry is justified by the aim to ensure the environmental effectiveness of the Emission Trading Scheme.

As already mentioned above under point 3.1, the main argument of the Norwegian Government is that installations should not be given the impression that they, via a strategic behaviour, may affect the number of allowances they will receive for the next trading period, the period starting in 2013. By sticking to the historic period of 1998-2001, the “message” is sent that the Government will not in the future grant allowances for free based on the amount of emissions in the trading period 2008-2012.²⁶ In contrast, *“a moving base period from the first to the second trading period could have given reason for installations to expect that future base periods could include years in which they can influence emissions, and thus motivate strategic behaviour. Other alternatives such as benchmarks or projections would create expectations that full costs need not be paid in the future. This could lead to investments that are not environmentally justified.”*²⁷

²⁵ Commission Decision of 29 November 2006 concerning the national allocation plan notified by Germany, paragraph 23, cited above under point II.3.2.

²⁶ Norwegian Government’s response to the Authority’s questions, submitted by letter dated 30 May 2008, p. 1 and 5-6.

²⁷ Norwegian Allocation Plan for the Emission Trading System in 2008-2012, p. 12. See similarly, Ot.prp. nr. 66 (2006-2007), points 3.2.1 and 3.2.3.

In the opinion of the Authority, the wish to send a message for a *future* trading period cannot justify the above-shown difference of treatment in a previous trading period. Moreover, even assuming that such a wish could, in principle, have justified the difference of treatment flowing from the national plan, the Authority fails to see why such message could not be sent in another way that did not entail discrimination. In the opinion of the Authority, the Norwegian government has not shown why it is necessary to discriminate in order to achieve the aim of combating strategic behaviour. Therefore, the difference of treatment would, in any event, not satisfy the requirement of proportionality.

Finally, the decisive way of avoiding strategic behaviour must be to affect the perception of future events that existing or potential new installations would have *during* the trading period up to 2012. In this connection, it could be argued that to change the allocation criteria for the period 2008-2012 compared to the previous period, as Norway has done, in itself raises questions as to the consistency of the national policy and might, in fact, be a signal that even more changes might occur with regard to the trading period as from 2012. In addition, also a whole range of other factors might affect the perception that the installations might have as to the future allocation methodology. Such factors include the fact that the relevant European legal framework will be subject to major amendments. These amendments might even indicate that the Norwegian objective of not allocating allowances for free at all after 2012 may perhaps not be achieved. Indeed, the Government itself states that its position that no business shall rely upon allocation free of charge post 2012 might have to be reconsidered in light of future revisions of the EU directive on emissions trading.²⁸ On that basis, the Authority doubts the effectiveness, and hence the suitability, of the “message” concerning the post-2012 trading period.

What influences the overall environmental achievements of the scheme is first and foremost the total cap. The allocation methodology chosen by Norway has no real impact on the total cap.

The Norwegian Government argues that the allocation of allowances, whether free of charge or sold, does not affect the incentives to increase or decrease production and emissions.²⁹ According to the Government’s reasoning, the economic gain linked to reduced emissions would be the price of allowances, either as a result of selling allowances received free of charge or as a result of having to buy fewer allowances. Consequently, regardless of whether the allowances are sold or allocated free of charge, companies would reduce emissions as long as the costs of emission reductions are equal to or below the price of allowances.³⁰ Hence, a uniform market price of allowances will ensure that all polluters face the same marginal costs of pollution.

However, as acknowledged by the Norwegian Government, granting allowances free of charge may reduce the immediate financial burden for the operators, while not

²⁸ Norwegian Allocation Plan for the Emission Trading System in 2008-2012, p. 6. See similarly Ot.prp. nr. 66 (2006-2007), point 1.

²⁹ Norwegian Government’s response to the Authority’s questions, submitted by letter dated 30 May 2008, p. 11-12.

³⁰ Norwegian Government’s response to the Authority’s questions, submitted by letter dated 30 May 2008, p. 4.

necessarily reducing the cost efficiency of the system.³¹ Thus, the Government acknowledges that economic advantages are granted to certain undertakings only and that this situation results in a difference of treatment between undertakings operating in the same competitive environment.

The Authority finds that the argument put forward by the Norwegian Government cannot justify allocating such lump sums differently depending on whether installations had emissions during the base period 1998-2001 or not. Indeed, in such a scenario the only effect of the Norwegian allocation methodology would be that certain undertakings, those already in operation before 2002, get handouts while those undertakings starting their operations only after 2001, which operate on the same markets and face the same competitive environment, do not receive anything. In other words, assuming that the Norwegian Government was correct when it argues that the individual undertaking's incentive to reduce its emissions does not differ according to whether the allowances were sold or granted free of charge, then one would also have assume that the differentiated treatment between existing undertakings would not have any positive effects on the undertakings' incentive to reduce emissions. Hence, even under such assumption the difference would not have been justified by the environmental objective of the scheme.

In the opinion of the Authority, it might in fact be argued that the chosen allocation methodology could turn out to be counterproductive. Indeed, by not requiring installations benefiting from allowances free of charge to deliver their environmental counterpart, the result could be that old installations potentially using less environmentally friendly technologies are preserved, as they will be granted allowances free of charge without being compelled to reduce their emissions. In comparison, more recent installations, which are more likely to use environmentally friendly technologies, are punished, as they will have to buy all their allowances. It is difficult to see this as an environmental justification of the trading scheme.

Hence, the Authority finds that the Norwegian Government has not provided arguments related to safeguarding the environmental integrity of the scheme which could justify the distortion of competition arising from the application of its allocation methodology.

3.4. Conclusion

The Authority considers that the Norwegian methodology of allocating allowances free of charge to land-based existing installations, depending entirely on when they started operations, contravenes criterion 5 of Annex III in so far as it favours installations that were already operating before 2002 compared to installations that started to operate only after 2001. For the same reason, the Authority cannot exclude that the plan could potentially imply State aid pursuant to Article 61(1) of the EEA Agreement. Nor can the Authority, on the basis of information provided by Norway, exclude that any aid involved would be found incompatible with the functioning of the EEA Agreement, should it be assessed in accordance with Article 61 of

³¹ Norwegian Government's response to the Authority's questions, submitted by letter dated 30 May 2008, p. 3. This is confirmed on p. 11, where the Government recognised that "[a] certain amount of allowances handed out for free will indeed improve the immediate financial situation for the receiving company".

the EEA Agreement and Article 1 of Part I of Protocol 3 to the Surveillance and Court Agreement.

It is for the Norwegian authorities to decide whether this difference of treatment should be remedied by granting allowances to all existing installations or by auctioning the allowances or selling them in another way. In this respect, they can both increase and decrease the number of allowances that is given for free.³² Also other solutions might be envisaged, including ways to allocate allowances for free, wholly or partially, according to technological parameters. As already stated, it is not for the Authority to interfere with the percentage of allowances that the State gives for free respectively the amount it intends to auction or sell in any other way.

4. Land-based new entrants

4.1. Introduction

As explained above in section I, point 2, and section II, point 3.1, the Norwegian allocation plan contains no general reserve of free allowances for new entrants for the trading period from 2008 to 2012. Nor will allowances be allocated free of charge to compensate for increased activity at existing installations, i.e. installations with emissions from regular activities before 1 July 2007. Therefore, for new entrants, the general principle is that they have to buy all allowances needed on the market.

However, Section 7(4) of the Norwegian Act foresees the establishment of a specific reserve for allowances free of charge for new gas-fired power plants based on carbon capture and storage (CCS) technology and highly efficient combined heat and power (CHP) plants.

This reserve is limited to power plants that have not been in regular operation before the amendments to the Norwegian Act entered into force 1 July 2007. The Norwegian Government foresees the establishment of a reserve of 9 million allowances [9 million tonnes] for new entrants for the whole trading period from 2008 to 2012, or on average 1.8 million allowances a year.³³ The allocation to eligible new entrants could be between 75 and 92% of the expected emissions, depending on the environmental integrity of the plant.

The Authority would like to recall the key principles underlying the treatment of new entrants and the establishment of a new entrants' reserve. Regarding the treatment of new entrants in the Emission Trading Scheme, EEA States benefit from a certain degree of discretion as long as it is ensured that new entrants will have access to allowances. A certain difference of treatment between incumbents and new entrants could be justified, because new entrants can minimise their carbon costs through investment choices.³⁴ Whatever option is chosen to treat new entrants, in all cases, the

³² As for the possibility to limit the number of allowances for new entrants, see below under point 4.

³³ The amendments to the Greenhouse Gas Emission Trading Regulation, defining the details of the new entrants' reserve, have still not been formally adopted.

³⁴ That being said, according to point 140 of the new environmental guidelines, new entrants shall not "in principle" receive permits or allowances on more favourable conditions than existing undertakings operating on the same markets.

principle of equal treatment is the guiding principle relating to new entrants' access to allowances.³⁵ The Act leaves the option to EEA States to provide access to allowances free of charge out of a reserve to enable new entrants' participation in the Emission Trading Scheme. Accordingly, up to the amount of allowances in the reserve, new entrants would be given a free allocation.

When setting aside a reserve, the methodology that a State uses in order to allocate allowances from that reserve to new entrants should respect the principle of equal treatment. This implies that all new entrants should be treated in the same way, although certain adaptations might be made for justified reasons, in compliance with criterion 5. Hence, *"in case a Member State decides to set aside a reserve from which to grant allowances free of charge, the Commission recommends a Member State not to create dedicated reserves for special activities, technologies or purposes."*³⁶ Therefore, the Authority has examined the rules applying to new entrants in light of that principle.

4.2. Issues related to the definition of a "new entrant"

Pursuant to Article 3(h) of the Act, *"new entrant" means any installation carrying out one or more of the activities indicated in Annex I, which has obtained a greenhouse gas emissions permit or an update of its greenhouse gas emissions permit because of a change in the nature or functioning or an extension of the installation, subsequent to the notification [to the Commission] of the national allocation plan.*" This definition establishes that installations that have obtained their emission permit after notification of the allocation plan are considered to be new entrants. The same applies to existing installations that extend their capacity and obtain an updated emission permit after the date of the notification of the plan. Both are to be treated as new entrants as far as the extended capacity, and only that, is concerned.

The Norwegian allocation plan applies another definition of new entrants, in particular for the eligibility to the new entrants' reserve. As already indicated, the Norwegian definition of new entrants covers only new installations which have come into regular operation after 1 July 2007. Hence, unlike the definition laid down in Article 3(h) of the Act, the Norwegian allocation plan does not cover any extension of capacities of activities in existing installations.

Furthermore, concerning the cut-off date used to distinguish between incumbents and new entrants, the Act refers to the date when the permit or updated permit was obtained, i.e. the (updated) permit shall be subsequent to the notification of the national allocation plan in order for an installation to qualify as new entrant. In comparison, the Norwegian system refers to the date when the new installation started its regular operation, which must be from 1 July 2007 onwards, i.e. the date of entry into force of the amendments to the Norwegian Act pertaining to the trading period 2008–2012, in order for an installation to qualify as a new entrant eligible to the reserve.

³⁵ Reference is made to paragraph 51 of the NAP-1 guidance, concerning criterion 6. See also paragraph 61 thereof where the Commission specifies that, *"in order to respect the principle of equal treatment, the methodology that a Member State uses in order to allocate allowances to new entrants should as far as possible be the same as the one used for comparable incumbents"*.

³⁶ Paragraphs 61 and 64 of the NAP-1 guidance.

The definition of new entrants applied by Norway is therefore inconsistent with the definition of new entrants as defined in Article 3(h) of the Act. This divergent definition in itself constitutes a violation of the said provision. Moreover, the different definition has the practical effect that certain installations that should be considered as existing installations according to the Act are treated as new entrants under the Norwegian national allocation plan. As a consequence, certain installations that started operations after 1 January 2002 and thus would be granted no allowances for free according to the Norwegian allocation methodology could benefit from the specific new entrants' reserve.

As recognised by the Norwegian Government, if the definition in the Act were to apply, any installation established in Norway that had already obtained a greenhouse gas emissions permit at the time of the notification of the allocation plan would be excluded from applying for allowances free of charge from the reserve.³⁷ Such an installation would be treated as an existing installation and therefore be subject to the general allocation rules. Thus, it could imply that that undertaking should not receive any allowances free of charge.

The power plant at Kårstø obtained its greenhouse gas emissions permit on 15 March 2005. The permit was updated on 10 May 2005. Had the Norwegian allocation plan used the definition in the Act, Kårstø would have been an existing installation. It would therefore have been excluded from applying for an allocation free of charge from the specific new entrants' reserve. However, by applying the Norwegian definition of new entrant, the new gas-fired power plant at Kårstø, which started its production in November 2007, becomes eligible for an allocation free of charge from the new entrants' reserve as new gas-fired power plant based on CCS facility. This is so even though its permit dates from 2005.

Thus, the divergent definition of a new entrant laid down in the Norwegian allocation plan favours one particular installation, leading to an undue and discriminatory advantage to that installation, in breach of criterion 5 of Annex III to the Act. The Authority at this stage considers that the application by Norway of its particular definition of new entrant is not in conformity with the definition provided under the Act and moreover could constitute State aid which could be found incompatible with the functioning of the EEA Agreement, should it be assessed in accordance with Article 61 of the EEA Agreement and Article 1 of Part I of Protocol 3 to the Surveillance and Court Agreement.

4.3. The special reserve for new gas-fired power plants CCS and CHP plants

4.3.1. Introduction

The Authority has also examined the establishment of the special new entrants' reserve of allowances free of charge restricted to new gas-fired power plants based on carbon capture and storage (CCS) technology and highly efficient combined heat and power (CHP) plants that Norway intends to create.

³⁷ Norwegian Government's response to the Authority's questions, submitted by letter dated 30 May 2008, p. 16.

The Norwegian Government acknowledges that the establishment of a separate reserve will not lead to equal treatment of new entrants, certain installations obtaining a more favourable treatment. However, the Government believes the resulting discrimination is justified for environmental reasons since a selective reserve may lead to increased investment in environmentally friendly technologies. Concerning highly efficient CHP plants, the Norwegian Government considers that the reserve will promote the realisation of such power plants which use their energy more efficiently than traditional power plants, thus contributing to higher efficiency in the power sector. Concerning gas-fired power plants based on CCS technology, the Government considers that the reserve will contribute to the promotion of investment in CCS technologies. An operator contemplating to invest in a power plant will find that the existence of a special reserve set aside for power plants based on CCS technology lowers the threshold for equipping the power plant with CCS technology. Thus, handing out allowances free of charge only to power plants based on CCS technology will stimulate investment in this particular kind of technology.³⁸

As mentioned above, when setting aside a reserve, the methodology that a State uses in order to allocate allowances from that reserve to new entrants should respect the principle of equal treatment, although certain adaptations might be made for justified reasons, in compliance with criterion 5. In that respect, the Commission recommended not to create several reserves dedicated to separate activities, technologies or specific purposes, since they could result in unequal treatment between new entrants.³⁹ Similarly, the Commission has, in some cases, considered that the creation of sector specific new entrants' reserves unjustifiably discriminate between various groups of new entrants in that they automatically result in an undue advantage for certain groups of new entrants, notably in case a general new entrants' reserve is depleted first. The reason is that in such a case, certain groups of new entrants still receive an allocation of allowances for free although the general new entrants' reserve is depleted, while others need to buy allowances on the market. The creation of separate reserves automatically results in an advantage for new entrants in the beneficiary sectors (targeted sectors or undertakings) once the general new entrants' reserve is depleted.⁴⁰ This is even more so a concern where no general new entrants' reserve has been set aside, as it is foreseen in the Norwegian national allocation plan. A separate reserve constitutes an exception to the guiding principle of equal treatment of new entrants. Therefore, it needs to be interpreted in a restrictive manner and applied strictly.

4.3.2. The eligibility of highly efficient CHP installations

The Authority acknowledges that high efficiency combined heat and power installations may be treated more favourably in the Emission Trading Scheme. This is in line with the Act, which aims at encouraging the use of more energy-efficient technologies, including combined heat and power technology producing less emissions per

³⁸ Norwegian Government's response to the Authority's questions, submitted by letter dated 30 May 2008, p. 16-17.

³⁹ Reference is made to the NAP-1 guidance, section 2.1.6. relating to new entrants, in particular paragraph 61.

⁴⁰ Commission Decision of 29 November 2006 concerning the national allocation plan notified by Ireland, paragraph 13.

unit of output.⁴¹ The more favourable treatment of CHP installations has been accepted because of their environmental benefits as recognised in established Community policy, as long as the allocations do not exceed the expected needs of the installations concerned as determined by the BAT-benchmark. Therefore, the creation of a separate reserve limited to this purpose and respecting the requirement not to allocate beyond needs has been accepted within the EEA.⁴²

The reasons justifying the more favourable treatment granted to CHP are linked to the characteristics of cogeneration installations. By installing a high efficiency CHP at an industrial site, thus saving primary energy and reducing emissions globally, the industrial site increases its on-site fuel consumption and hence also the local CO₂ emissions on site. The heat network or industrial facility that the CHP plant is associated with, should it invest in high efficiency CHP to produce the required energy for its processes, will need to acquire additional allowances in order to cover its obligations under the Emission Trading Scheme. The focus on emission reductions has dissuaded companies from investing in CHP as they would have to face an increase in CO₂ emissions on their site. Given that cogeneration is recognised as the most efficient technology for converting primary fuel into electricity and heat (and thus minimising CO₂ emissions), it was found necessary to provide the right incentive to favour the establishment of new-cogeneration production against less energy efficient alternatives.⁴³ Accordingly, national allocation plans should be designed to encourage CHP compared to the separate production of electricity and heat, in order to ensure that this technology is incentivised and not confronted with disadvantages associated with the introduction of the Emission Trading Scheme.

Therefore, the Authority considers that the establishment of a specific new entrants' reserve for highly efficient CHP plants while respecting the requirement not to allocate beyond needs is justified in principle. This entails *inter alia* that the amount must take into account the energy efficiency and hence the overall emission reduction capacity of the CHP plants.

4.3.3. The eligibility of new gas-fired power plants based on CCS technology

The Authority considers that the reasoning justifying a more favourable treatment to cogeneration cannot be transposed to the case of CCS technology. A successful CCS technology has the potential for reducing most of the emissions from large point sources using fossil fuels. Contrary to cogeneration, CCS technology would directly reduce emissions from installations using such technology, and consequently the amount of allowances they would need to surrender under the Emission Trading Scheme, provided CCS activities are included within the scope of the Emission Trading Scheme. However, as it stands, CCS is not covered by the scheme and therefore emissions related to CCS activities fall outside the emission trading mechanism.

⁴¹ Recital 21 of the Act.

⁴² Commission Decision of 29 November 2006 concerning the national allocation plan notified by Ireland, paragraph 13.

⁴³ Directive of the European Parliament and of the Council of 11 February 2004 on the promotion of cogeneration based on a useful heat demand in the internal energy market and amending Directive 92/42/EEC (OJ 2004 L 52 p. 50) and the NAP-1 guidance, paragraph 90.

Article 24 of the Act offers the appropriate legal framework for unilateral inclusion of installations undertaking the capture, transport and geological storage of greenhouse gases. The Norwegian Government has already indicated that it was considering this possibility to opt in carbon capture and storage facilities into the Emission Trading Scheme.⁴⁴ Such an option would provide the right incentive as the obligation to surrender allowances could not be required in respect of emissions which are stored. This would imply a reduction in the overall amount of allowances an installation undertaking CCS would be obliged to surrender annually to cover its total emissions.

The special reserve aimed at stimulating investment in CCS technologies is based on the Norwegian Government's policy that all new gas-fired power plants shall have CCS technology. On the basis of the information submitted by the Norwegian Government, the only known installations that may be eligible for an allocation free of charge from the new entrants' reserve are the gas-fired power plant at Kårstø and the combined heat and power plant that is under construction at Mongstad.⁴⁵ These two first Norwegian gas-fired power plants, where CCS technology is foreseen to be installed, are also the two projects already identified by the Norwegian Government as eligible for support through other means. In this respect, the Authority has taken note of the fact that these two projects are subject to specific notifications of State aid measures to the Authority, with the objective to develop further that technology and to make it commercially viable in the future.

Furthermore, it stems from the Norwegian allocation plan that a power plant will not need to have established a full-scale capture facility in order to qualify for allocation from the new entrant reserve as a power plant "based on CCS technology". The intention is to hand out allocated allowances from the moment the power station is in regular operation. In other words, allowances may be granted before the capture, transport and storage facilities are operational. Accordingly, Kårstø would be allocated allowances from 1 January 2008 and Mongstad from the day the power station is expected to be in regular operation in 2010, although their full scale CCS facilities are, according to Norway, not expected to be operational before 2011-2012 and the end of 2014, respectively.

Given the current state of development of CCS technology and the fact that CCS activities fall outside the scope of the Emission Trading Scheme unless they are opted in pursuant to Article 24 of the Act, the Authority considers that the creation of a specific reserve for particular new entrants, i.e. new gas-fired power plants based on CCS technology is not justified by the objective of stimulating investment in CCS technology. Similarly, the Authority considers that the environmental benefit of any aid included in the allocation of allowances free of charge from the specific reserve will not be sufficient to outweigh the distortion of competition, given that it will not require beneficiaries to deliver an environmental counterpart for the benefit they receive from the moment they received allowances free of charge. Moreover, the Authority at this stage and on the basis of the currently available information cannot exclude that any State aid involved in the allocation to these particular new entrants may be found incompatible with the functioning of the EEA Agreement, should it be

⁴⁴ Norwegian Allocation Plan for the Emission Trading System in 2008-2012, p. 11 and 23.

⁴⁵ Norwegian Government's response to the Authority's questions, submitted by letter dated 30 May 2008, p. 18.

assessed in accordance with Article 61 of the EEA Agreement and Article 1 of Part I of Protocol 3 to the Surveillance and Court Agreement.

5. Necessity to amend the National allocation plan

In order to bring the national allocation plan in conformity with the criteria listed in Annex III to the Act, the plan should be amended. The Authority should be notified by Norway of the amendments made to the plan in accordance with this Decision as soon as possible, taking into account the time-scale necessary to carry out the national procedures without undue delay.

Information in the national allocation plan not relevant for the allocation of allowances for the period referred to in Article 11(2) of the Act has not been taken into account for the purposes of this Decision. In addition, information in the national allocation plan relating to Norway's intended unilateral inclusion of additional activities pursuant to Article 24 of the Act has not been taken into account for the purposes of this Decision but will be subject to a separate application by Norway and decision by the Authority as provided for in Article 24 of the Act.

Pursuant to Article 9(3), second sentence, of the Act, the EFTA State shall only take a decision under Article 11(2) of the Act if proposed amendments are accepted by the Authority. The Authority accepts all modifications of the allocation of allowances to individual installations within the total quantity to be allocated to installations listed therein that result from technical improvements to data quality. No further prior assessment and acceptance by the Authority is necessary in that case because the allocation methodology and the total quantity of allowances remain unchanged. As the modification is limited to mechanically adjusting the result from the use of data of higher quality having become available more recently to the intended allocation, any such modification cannot be conceived to be incompatible with the criteria of Annex III to the Act.

HAS ADOPTED THIS DECISION:


1. The following aspects of the national allocation plan of Norway for the first five-year period mentioned in Article 11(2) of the Act are incompatible respectively with:
 - Criterion 5 of Annex III to the Act: the allocation methodology by which allowances are determined at installation level with regard to land-based industry according to Section 7(2) and (3), cf. Section 8 (2) of the Norwegian Act of 17 December 2004 No. 99 relating to greenhouse gas emission allowance trading and the duty to surrender emission allowances, as amended on 29 June 2007, and referred to in Chapter 3.2 of the Norwegian allocation plan.
 - Criterion 5 of Annex III to the Act: the definition of a new entrant laid down in Chapter 3.2 of Norwegian national allocation plan in order to qualify for


the special reserve in Section 7(4) of the said Act of 17 December 2004 No. 99.

- Criterion 5 of Annex III to the Act: the creation of a special new entrants' reserve in Section 7(4) of the said Act of 17 December 2004 No. 99 to the extent the reserve applies to new gas-fired power plants based on carbon capture and storage (CCS) technology.
- 2. The total annual average quantity of allowances to be allocated by Norway according to its national allocation plan, which will be at least 20% below the 2005 verified emissions from the installations obliged to surrender emission allowances, shall not be exceeded.
- 3. The national allocation plan may be amended without prior acceptance by the Authority if the amendment consists in modifications of the allocation of allowances to individual installations within the total quantity to be allocated to installations listed therein resulting from improvements to data quality.
- 4. Any amendments of the national allocation plan made to correct the incompatibilities indicated in paragraph 1 of this Decision must be notified as soon as possible, taking into account the time-scale necessary to carry out the national procedures without undue delay, and require prior acceptance by the Authority pursuant to Article 9(3) of the Act.
- 5. This Decision shall enter into force on its notification.
- 6. This Decision is authentic in the English language.
- 7. This Decision is addressed to Norway and shall be notified to that State.

Done at Brussels, 16 July 2008.

For the EFTA Surveillance Authority


Per Sanderud
President


Kurt Jaeger
College Member

